



Spotlight

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A New Paradigm in International Investing?

London-based Barings seeks to blend top-down and bottom-up research to maximum effect.

Baring Asset Management (Barings), manager of the Aston/Barings International Fund, employs a comprehensive approach to buying foreign stocks. Whereas most managers that invest overseas focus on either bottom-up research into individual companies or top-down country or industry themes, Barings believes that successful foreign investors need to do both effectively to root out the best opportunities across the globe. The venerable investment manager recognizes that macroeconomic factors overseas can be just as influential to the performance of a stock as a company's underlying fundamentals. Thus, Barings integrates active stock selection with both active country and sector analysis. Their investment philosophy boils down to the desire not just to buy a good house (stock), but a good house in a good neighborhood (country or sector).

Although using top-down country or sector research isn't necessarily new or special, Barings method of analyzing which factor—country, sector, or company fundamentals—is the primary source of a stock's return is innovative. The formalized process not only receives inputs from all three areas, but assesses the impact of each on a stock's return potential. For example, returns among energy stocks tend to be quite homogenous, often driven by the fluctuating price of oil or gas in the near-to-medium term than company or country specific factors. Similarly, economic trends within certain countries are so dominant that movement in a company's share value often has little to do with the quality of its underlying fundamentals.

Barings uses a regression analysis to weight the relative influence of stock, sector, and country specific characteristics for each individual stock. A Strategic Policy Group meets once a month to consider global country and sector preferences based on a number of fundamental metrics, along with liquidity and mean-reversion risk measurements. Sixty global analysts across Europe and Asia perform detailed research on more than 800 companies focusing on growth, valuation, and the effectiveness of management. The best weighted scores from this optimization process provides a list of the highest conviction stocks in the fund's universe as a starting point from which to construct a portfolio.

Stock Selection Remains Key

Although formalized to produce consistent and repeatable outcomes, the strategy is not a rigid system that seeks to lessen the need for sound judgment on the part of fund manager David Bertocchi and the team of analysts. Barings firmly believes that successful investing requires a level of flair and flexibility to recognize important and unique variables from country to country, sector to sector, and stock to stock. Good old-fashioned stock picking is still the key determinant of performance. Each stock is ranked on a scale from 1 to 5 (with a 1 equating to a strong conviction that the stock will outperform the local market index during the next 12 months). The portfolio won't own any of the low-ranked (4 or 5) stocks regardless of the country or sector view.

Analysts also have significant latitude in choosing stocks of all sizes to cover. The goal is to strike a balance between the big, important companies that make up a significant part of the fund's MSCI EAFE Index benchmark and non-core ideas that offer the greatest potential for outsized returns. An understanding of local customs and culture by researchers on the scene, plus a dual role on geographic and sector teams, allows each



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analyst to assess a company's competitive advantages both locally and beyond. Continual interaction between managers and analysts deepens the debate on particular stocks and can help to identify early warning signs and underlying issues before the market can pick them up.

Contrarian Edge

Underscoring the entire process is a contrarian approach that aims to benefit from the power of its convictions. Most growth managers focus on larger companies or those with high historic growth rates, firms that Barings believes to be systematically overpriced. Instead, analysts seek companies with unrecognized growth prospects from key drivers that can lead to positive earnings surprises above consensus expectations over the following two to three years. Bertocchi's goal is to buy such stocks at a bargain (i.e. a fair price given consensus expectations), confirming that the growth insights of the analyst team are truly unrecognized.

Patience and discipline matter. Great research can often fail through poor execution and timing. That's why identifying the best stocks and being prepared to move quickly at market inflection points is critical, and why Bertocchi typically buys a full position of a stock he likes on day one. In addition, the Barings' philosophy is that a relatively concentrated and equal-weighted portfolio compels the manager to commit and show conviction, encouraging Bertocchi to weed out losers as better ideas come to the fore and not stubbornly stick with stocks that should have done well but haven't.

Diverse Process

It has been observed within international equity markets that stock selection is more important in the West, while asset allocation drives performance in the East (Asia/Emerging Markets). Barings would wholeheartedly agree with that sentiment. Whereas bottom-up stock picking alone can often deliver strong results here in the U.S., on the global front the picture is more complex. Thus, its concept of assessing the primary sources of a stock's return as a first step in constructing a portfolio can be an advantage over more one-dimensional stock-picking strategies or ad hoc models of global sector and country trends. By employing such a methodical and diverse research approach, Barings seeks to provide a platform for repeatable success across the globe in a variety of market environments.

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